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and capable of satisfactory performance, (2) possessed of an adequate accounting system and controls, and (3) in sound financial condition, progress payments in amounts requested by the contractor should be approved as a matter of course.

(b) For all other contractors, the ACO shall not approve progress payments before determining (1) that (i) the contractor will be capable of liquidating any progress payments or (ii) the Government is otherwise protected against loss by additional protective provisions, and (2) that the contractor's accounting system and controls are adequate for proper administration of progress payments. The services of the responsible audit agency or office should be used to the greatest extent practicable. However, if the auditor so advises, a complete audit may not be necessary.

[48 FR 42328, Sept. 19, 1983, as amended at 63 FR 9061, Feb. 23, 1998]

32.503-4 Approval of progress payment requests.

- (a) When the reliability of the contractor and the adequacy of the contractor's accounting system and controls have been established (see 32.503-3 above) the ACO may, in approving any particular progress payment request (including initial requests on new contracts), rely upon that accounting system and upon the contractor's certification, without requiring audit or review of the request before payment.
- (b) The ACO should not routinely ask for audits of progress payment requests. However, when there is reason to (1) question the reliability or accuracy of the contractor's certification or (2) believe that the contract will involve a loss, the ACO should ask for a review or audit of the request before payment is approved or the request is otherwise disposed of.
- (c) When there is reason to doubt the amount of a progress payment request, only the doubtful amount should be withheld, subject to later adjustment after review or audit; any clearly proper and due amounts should be paid without awaiting resolution of the differences.

32.503-5 Administration of progress payments.

- (a) While the ACO may, in approving progress payment requests under 32.503–3 above, rely on the contractor's accounting system and certification without prepayment review, postpayment reviews (including audits when considered necessary) shall be made periodically, or when considered desirable by the ACO to determine the validity of progress payments already made and expected to be made.
- (b) These postpayment reviews or audits shall, as a minimum, include a determination of whether or not—
- (1) The unliquidated progress payments are fairly supported by the value of the work accomplished on the undelivered portion of the contract;
- (2) The applicable limitation on progress payments in the Progress Payments clause has been exceeded;
- (3)(i) The unpaid balance of the contract price will be adequate to cover the anticipated cost of completion, or
- (ii) The contractor has adequate resources to complete the contract; and
- (4) There is reason to doubt the adequacy and reliability of the contractor's accounting system and controls and certification.
- (c) Under indefinite-delivery contracts, the contracting officer should administer progress payments made under each individual order as if the order constituted a separate contract, unless agency procedures provide otherwise. When the contract will be administered by an agency other than the awarding agency, the contracting officer shall coordinate with the contract administration office if the awarding agency wants the administration of progress payments to be on a basis other than order-by-order.

[48 FR 42328, Sept. 19, 1983, as amended at 65 FR 16280, Mar. 27, 2000; 68 FR 13208, Mar. 18, 2003]

32.503-6 Suspension or reduction of payments.

(a) General. The Progress Payments clause provides a Government right to reduce or suspend progress payments, or to increase the liquidation rate, under specified conditions. These conditions and actions are discussed in paragraphs (b) through (g) below.

- (1) The contracting officer shall take these actions only in accordance with the contract terms and never precipitately or arbitrarily. These actions should be taken only after—
- (i) Notifying the contractor of the intended action and providing an opportunity for discussion;
- (ii) Evaluating the effect of the action on the contractor's operations, based on the contractor's financial condition, projected cash requirements, and the existing or available credit arrangements; and
- (iii) Considering the general equities of the particular situation.
- (2) The contracting officer shall take immediate unilateral action only if warranted by circumstances such as overpayments or unsatisfactory contract performance.
- (3) In all cases, the contracting officer shall (i) act fairly and reasonably, (ii) base decisions on substantial evidence, and (iii) document the contract file. Findings made under paragraph (c) of the Progress Payments clause shall be in writing.
- (b) Contractor noncompliance. (1) The contractor must comply with all material requirements of the contract. This includes the requirement to maintain an efficient and reliable accounting system and controls, adequate for the proper administration of progress payments. If the system or controls are deemed inadequate, progress payments shall be suspended (or the portion of progress payments associated with the unacceptable portion of the contractor's accounting system shall be suspended) until the necessary changes have been made.
- (2) If the contractor fails to comply with the contract without fault or negligence, the contracting officer will not take action permitted by paragraph (c)(1) of the Progress Payments clause, other than to correct overpayments and collect amounts due from the contractor.
- (c) Unsatisfactory financial condition. (1) If the contracting officer finds that contract performance (including full liquidation of progress payments) is endangered by the contractor's financial condition, or by a failure to make progress, the contracting officer shall require the contractor to make addi-

- tional operating or financial arrangements adequate for completing the contract without loss to the Government.
- (2) If the contracting officer concludes that further progress payments would increase the probable loss to the Government, the contracting officer shall suspend progress payments and other payments until the unliquidated balance of progress payments is eliminated.
- (d) Excessive inventory. If the inventory allocated to the contract exceeds reasonable requirements (including a reasonable accumulation of inventory for continuity of operations), the contracting officer should, in addition to requiring the transfer of excessive inventory from the contract, take one or more of the following actions, as necessary, to avoid or correct overpayment:
- (1) Eliminate the costs of the excessive inventory from the costs eligible for progress payments, with appropriate reduction in progress payments outstanding.
- (2) Apply additional deductions to billings for deliveries (increase liquidation).
- (e) Delinquency in payment of costs of performance. (1) If the contractor is delinquent in paying the costs of contract performance in the ordinary course of business, the contracting officer shall evaluate whether the delinquency is caused by an unsatisfactory financial condition and, if so, shall apply the guidance in paragraph (c) above. If the contractor's financial condition is satisfactory, the contracting officer shall not deny progress payments if the contractor agrees to—
 - (i) Cure the payment delinquencies;
- (ii) Avoid further delinquencies; and (iii) Make additional arrangements adequate for completing the contract
- without loss to the Government.
 (2) If the contractor has, in good faith, disputed amounts claimed by subcontractors, suppliers, or others, the contracting officer shall not consider the payments delinquent until the amounts due are established by the parties through litigation or arbitration. However, the amounts shall be excluded from costs eligible for progress payments so long as they are disputed.

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- (3) Determinations of delinquency in making contributions under employee pension, profit sharing, or stock ownership plans, and exclusion of costs for such contributions from progress payment requests, shall be in accordance with paragraph (a)(3) of the clause at 52.232–16, Progress Payments, without regard to the provisions of 32.503–6.
- (f) Fair value of undelivered work. Progress payments must be commensurate with the fair value of work accomplished in accordance with contract requirements. Governed by the principles of paragraphs (c) and (e) of this subsection, the contracting officer must adjust progress payments when necessary to ensure that the fair value of undelivered work equals or exceeds the amount of unliquidated progress payments. On loss contracts, the application of a loss ratio as described in paragraph (g) of this subsection constitutes this adjustment.
- (g) Loss contracts. (1) If the sum of the total costs incurred under a contract plus the estimated costs to complete the performance are likely to exceed the contract price, the contracting officer shall compute a loss ratio factor and adjust future progress payments to exclude the element of loss. The loss ratio factor is computed as follows:
- (i) Revise the current contract price used in progress payment computations (the current ceiling price under fixed-price incentive contracts) to include any pending change orders and unpriced orders to the extent funds for the orders have been obligated.
- (ii) Divide the revised contract price by the sum of the total costs incurred to date plus the estimated additional costs of completing the contract performance.
- (2) If the contracting officer believes a loss is probable, future progress payment requests shall be modified as follows:
- (i) The contract price shall be the revised amount computed under subparagraph (1)(i) above.
- (ii) The total costs eligible for progress payments shall be the product of (A) the sum of paid costs eligible for progress payments times (B) the loss ratio factor computed under subparagraph (1)(ii) above.

- (iii) The costs applicable to items delivered, invoiced, and accepted shall not include costs in excess of the contract price of the items.
- (3) The contracting officer may use audit assistance, technical services, management reports, and other sources of pertinent data to evaluate progress payment requests. If the contracting officer concludes that the contractor's figures in the contractor's progress payment request are not correct, the contracting officer shall—
- (i) In the manner prescribed in paragraph (4) below, prepare a supplementary analysis to be attached to the contractor's request;
- (ii) Advise the contractor in writing of the differences; and
- (iii) Adjust all further progress payments in accordance with paragraph (1) above, using the contracting officer's figures, until the difference is resolved.
- (4) The following is an example of the supplementary analysis required in paragraph (g)(3) of this subsection:

Section I

\$2,850,000

750,000

Contract price.

Change orders and un- priced orders (to extent funds have been obli-	
gated)	150,000
Revised contract price	3,000,000
Section II	
Total costs incurred to date Estimated additional	2,700,000
costs to complete	900,000
Total costs to complete	3,600,000
Loss ratio factor $\frac{\$3,000,000}{\$3,600,000} =$	83.3%
Total costs eligible for progress payments	2,700,000
Loss ratio factor Recognized costs for	×83.3%
progress payments	2,249,100
Progress payment rate	×80.0%
Alternate amount to be used	1,799,280
Section III	
Factored costs of items	

delivered*

Federal Acquisition Regulation

Recognized costs applicable to undelivered items

(\$2,249,100-750,000) 1,499,100

*This amount must be the same as the contract price of the items delivered.

[48 FR 42328, Sept. 19, 1983, as amended at 52 FR 30077, Aug. 12, 1987; 54 FR 5056, Jan. 31, 1989; 54 FR 48989, Nov. 28, 1989; 64 FR 72451, Dec. 27, 1999; 65 FR 16280, Mar. 27, 2000]

32.503-7 [Reserved]

32.503-8 Liquidation rates—ordinary method.

The Government recoups progress payments through the deduction of liquidations from payments that would otherwise be due to the contractor for completed contract items. To determine the amount of the liquidation, the contracting officer applies a liquidation rate to the contract price of contract items delivered and accepted. The ordinary method is that the liquidation rate is the same as the progress payment rate. At the beginning of a contract, the contracting officer must use this method.

[65 FR 16280, Mar. 27, 2000]

32.503-9 Liquidation rates—alternate method.

- (a) The liquidation rate determined under 32.503–8 shall apply throughout the period of contract performance unless the contracting officer adjusts the liquidation rate under the alternate method in this 32.503–9. The objective of the alternate liquidation rate method is to permit the contractor to retain the earned profit element of the contract prices for completed items in the liquidation process. The contracting officer may reduce the liquidation rate if—
- (1) The contractor requests a reduction in the rate;
- (2) The rate has not been reduced in the preceding 12 months;
- (3) The contract delivery schedule extends at least 18 months from the contract award date;
- (4) Data on actual costs are available (i) for the products delivered, or (ii) if no deliveries have been made, for a performance period of at least 12 months;
- (5) The reduced liquidation rate would result in the Government recouping under each invoice the full ex-

tent of the progress payments applicable to the costs allocable to that invoice:

- (6) The contractor would not be paid for more than the costs of items delivered and accepted (less allocable progress payments) and the earned profit on those items;
- (7) The unliquidated progress payments would not exceed the limit prescribed in paragraph (a)(4) of the Progress Payments clause;
- (8) The parties agree on an appropriate rate; and
- (9) The contractor agrees to certify annually, or more often if requested by the contracting officer, that the alternate rate continues to meet the conditions of subsections 5, 6, and 7 above. The certificate must be accompanied by adequate supporting information.
- (b) The contracting officer shall change the liquidation rate in the following circumstances:
- (1) The rate shall be increased for both previous and subsequent transactions, if the contractor experiences a lower profit rate than the rate anticipated at the time the liquidation rate was established. Accordingly, the contracting officer shall adjust the progress payments associated with contract items already delivered, as well as subsequent progress payments.
- (2) The rate shall be increased or decreased in keeping with the successive changes to the contract price or target profit when—
- (i) The target profit is changed under a fixed-price incentive contract with successive targets; or
- (ii) A redetermined price involves a change in the profit element under a contract with prospective price redetermination at stated intervals.
- (c) Whenever the liquidation rate is changed, the contracting officer shall issue a contract modification to specify the new rate in the Progress Payments clause. Adequate consideration for these contract modifications is provided by the consideration included in the initial contract. The parties shall promptly make the payment or liquidation required in the circumstances.